No. 8—July, 1955

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Business in Brief

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THE CHASE MANHATTAN BANK

An air of optimism dominates the business scene. Production, employment, incomes and consumption are at new high levels. And there's a growing feeling that the second half will be better than the first.

It is recognized that autos and homebuilding probably can't maintain their record pace. Thus the business curve may flatten out in the current quarter.

But activity is expected to move higher by year-end. Business capital expenditures, inventory purchases and consumer buying are rising. Increases here should suffice to lift over-all activity moderately during the fourth quarter.

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Are there any weak spots in the business picture? Developments in several areas point to the need for caution in appraising business prospects:

- **Inventory buying is beginning to pick up.** Inventories are now somewhat low in relation to sales, so some pick-up may be warranted. But the danger is that over-confidence may breed an inventory boom this year and necessitate an adjustment in 1956.
- **The auto and steel wage settlements** will undoubtedly be followed by other wage increases. With production moving up towards capacity in the economy, the problem of maintaining price stability will be increasingly difficult. (See pages 4 and 5.)
- **Instalment and mortgage credit** have been rising rapidly, reflecting the high level of auto sales and new housing starts. If, as now seems likely, autos and housing slow down in the second half, the rise in credit extensions will taper off. But repayments will stay high.
- **The stock market** is above the high level reached at year-end 1954. The Dow-Jones industrial average had advanced a further 11% as of July 14.

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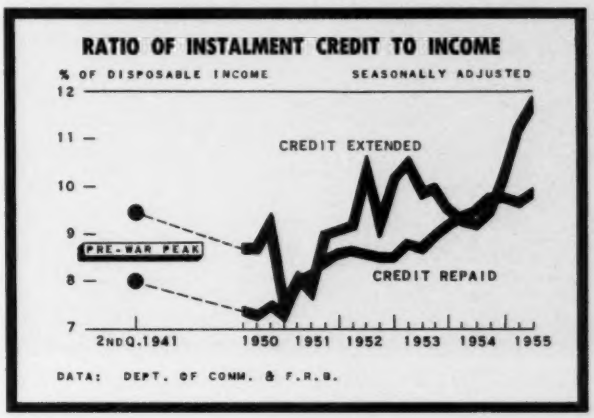
Each of these areas is a potential trouble spot. At this juncture, none of them seems likely to upset general business in the months immediately ahead. But they'll bear close watching as we move through the rest of 1955 and into 1956.

Instalment credit is at a record high—both in absolute terms and in relation to incomes. Does this mean that consumers have become over-burdened with debt? The latest Survey of Consumer Finances reveals these facts about instalment credit:

- Less than half of all families owe instalment debt. And two-thirds of these pay instalments of less than 20% of their income.
- Young married couples account for most of the other third. They use credit to set up housekeeping and many of them can look forward to rising incomes.
- Almost 60% of all instalment credit is paid off in a year or less.

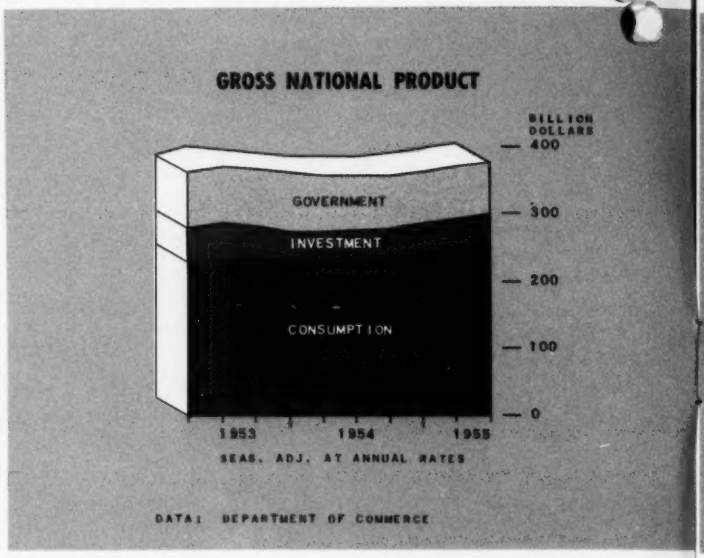
Also, delinquency rates are near their post-war lows.



It seems probable that the current rate of expansion of consumer credit will not continue. However, there is no inherent reason why the total will not rise somewhat as the long-term demand for durables grows.

Responsible credit management does not require that consumer credit be held at an arbitrary level. The objective is to extend credit on terms that are sound for both borrower and lender.

Recent tendencies to lengthen terms should be examined in this light. The lender in particular bears a responsibility to exercise restraint—a responsibility of increasing importance as consumer debt grows.



1 Business is at an all-time high. Newly revised Commerce Department estimates show that gross national product has now passed $380 billion (1953 peak: $369 billion). Industrial production, with the FRB index at 139, has set new records, too. The recession of 1953-54 proved to be one of the mildest on record.

What prevented the recession from snowballing into a cumulative decline? What sparked the recovery? And will these forces sustain the expansion in the period ahead?

To answer these questions, it's necessary to look at different segments of the total picture.

CHANGES IN GNP

	2ND Q. 1953 To 2ND Q. 1954	2ND Q. 1954 To 2ND Q. 1955
	BILLION DOLLARS	
GROSS NATIONAL PRODUCT	-12	+29
CONSUMPTION	+4	+15
DURABLES	-2	+6
AUTOS	-1	+3
INVESTMENT	-8	+8
DURABLE EQUIPMENT	-2	-1
TOTAL CONSTRUCTION	+1	+4
HOUSING	+1	+3
CHANGE IN INVENTORIES	-7	+4
NET FOREIGN INVESTMENT	+2	+1
GOVERNMENT	-8	+1
NATIONAL SECURITY	-9	-2
STATE AND LOCAL	+3	+3

DATA: DEPARTMENT OF COMMERCE

2 Most of the decline from 1953 to 1954 was caused by a drop in inventory investment ($7 billion), defense spending ($9 billion) and other Federal expenditures ($3.0 billion).

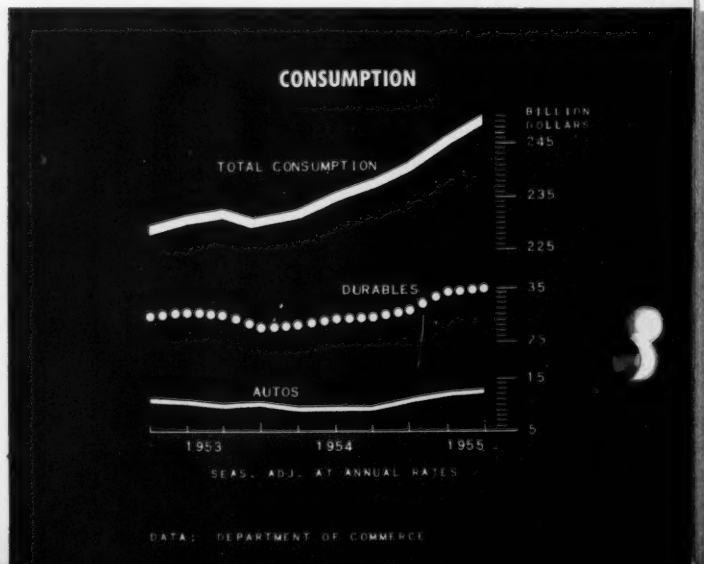
The rest of the economy, on balance, continued to grow: consumption and construction held steady; outlays on durable equipment remained surprisingly strong; state and local spending rose; and net foreign investment was up.

Then, in late 1954, defense spending leveled out. This, plus a new surge in consumption, caused an inventory turn-around, and the recovery was under way.

3 Consumption—more than any other sector—blunted the force of the downturn and sparked the recovery. Consumption continued strong because:

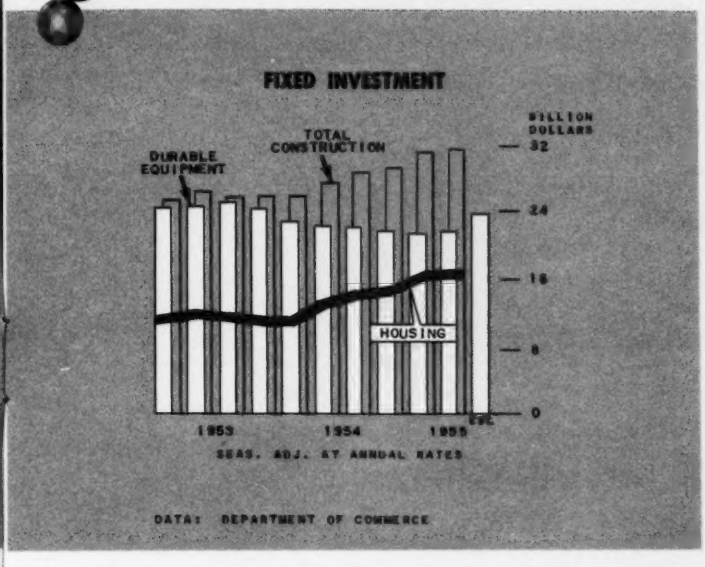
- A cut in personal income taxes in 1954 buoyed up consumers' income after taxes.
- In addition, the American consumer curtailed his savings and spent a larger share of his income after taxes on consumer goods.

The dramatic success of the new auto models encouraged spending further. A fifth of the rise in total consumption is accounted for by auto sales, and two-fifths by consumer durables.



TRENDS

Sustaining Forces Ahead



4 Fixed investment held up exceedingly well in the recession and is now rising sharply. This was the first recession in history in which fixed investment did not decline.

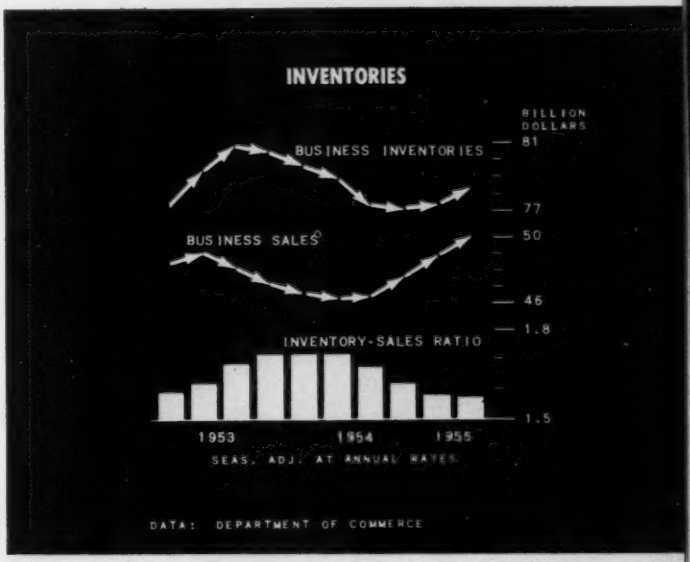
Construction helped support fixed investment. Housing starts soared from a rate of 1.0 million in early 1954 to 1.4 million in early 1955. Easier credit terms were an important prop.

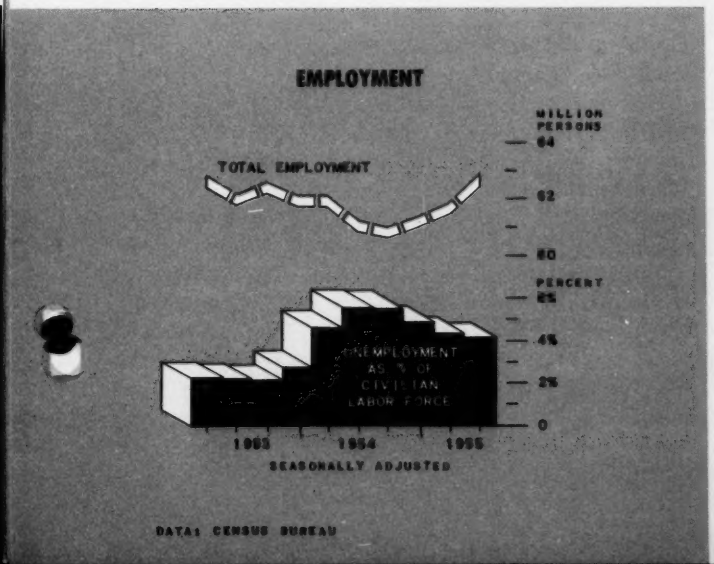
Durable equipment fell off, but far less than in earlier recessions. Plans to invest in the period ahead are strong and rising. Strength here should more than offset any possible weakness in housing.

5 Inventories, as usual, intensified the swing—both on the downside and the upside. With sales falling off in late 1953, producers were caught with surplus stocks.

But business gradually trimmed off its excess fat in 1954. (Inventories were cut close to $3 billion.) Inventories, when related to current sales, are in good shape today.

Thus, business began adding to stocks again in 1955. Inventories should continue to rise with sales and output in the months ahead. However, an inventory "boom"—in which inventories rise faster than sales—is a possibility that can't be ruled out.





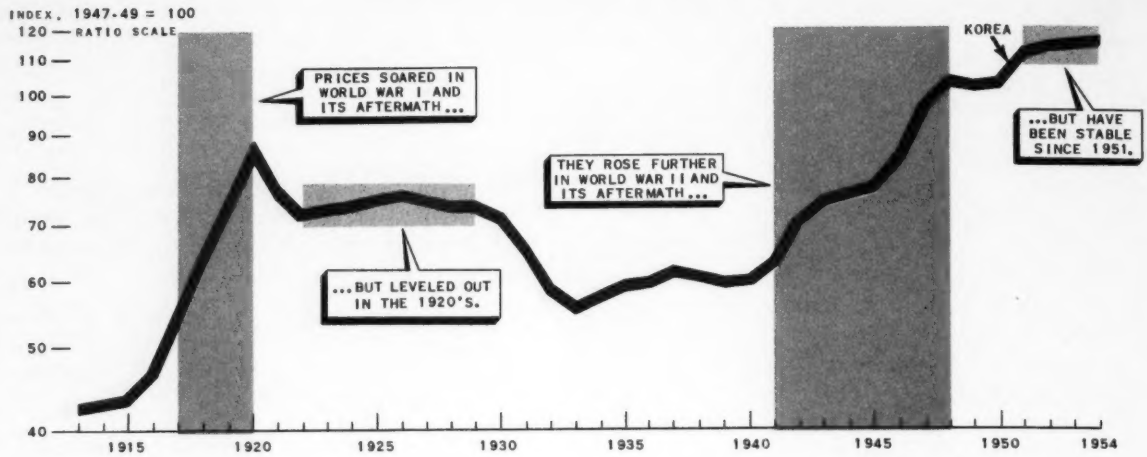
6 Meanwhile, employment is picking up. Jobs broke all records in early 1953, then eased off in 1954.

Unemployment (seasonally adjusted) rose to 5.5% of the labor force in 1954. With rising business, it has dropped to 3.8% or about 2.5 million.

Since minimum "frictional" unemployment is 3%, the economy has not yet reached full productive capacity.

When you add up all the trends within the economy, however, it is clear that the recovery is strong and should continue. Thus, it is possible that we may achieve full employment of our productive potential in the year ahead.

HOW THE COST OF LIVING HAS CHANGED...



DATA: BUREAU OF LABOR STATISTICS

LONG RUN PRICE MOVEMENTS

The recent wage agreements in autos and steel have led many businessmen to ask:

- Are we in for another upward spin of the wage-price spiral?
- Does this mean that our economy has a permanent inflationary "bias"?

Hard and fast answers to these questions should be treated with great caution. For the problem of inflation is an exceedingly complicated one—it's one of those problems on which the only sure answers begin with the phrase: "It all depends".

However, it is possible to set forth the major factors that influence price trends and examine their behavior. While this may not provide ready answers, it serves to illuminate the problem.

What is Inflation?

Inflation is a rise in the general level of prices. In its simplest terms it is the result of too much purchasing power chasing after a limited supply of goods.

The supply of purchasing power (i.e. the supply of money and credit) is importantly influenced by government monetary and fiscal policy. Thus a government cash deficit is usually financed in ways that add to the money supply.

The supply of goods is determined by the available labor force, industrial capacity and the economy's productivity (or output per man-hour).

To see how inflation is generated, look at how these factors have operated in the past.

The two dramatic examples of inflation during the past 40 years occurred in wartime. Prices doubled in World War I; rose almost two-thirds during World War II; and went up 10% after the Korean Invasion.

In wartime, purchasing power is pumped up as the government runs large deficits. And the supply of civilian goods is limited because factories are turning out munitions.

In depressions the economy has plenty of excess capacity. A government deficit helps increase private spending—if it is not accompanied by measures that repress private initiative. And increased spending can be matched by increased production so prices in general do not necessarily rise.

In prosperous peacetime years, the price level has usually been reasonably stable. In these periods the increase in production matched moderate increases in the money supply. Wage rates rose, but no faster than the rise in productivity.

Recent Price Trends

Prices have been remarkably stable for the past 3½ years. Consumer prices have fluctuated within a range of 1½%. This is true despite a 4% increase in the money supply, a 12% rise in manufacturing wage rates and a small Federal cash deficit.

The stability of price averages conceals some divergent trends in individual prices, of course. Most notable has been the downtrend in farm prices—they've dropped 15% since 1952 (though the downtrend leveled out during the past 6-9 months). Industrial prices have been inching up—they're 1% above their 1952 level.

This record shows the lack of any simple mechanical connection between the general level of prices and the money supply; prices and government deficits; or prices and wage rates. Moreover, it shows that in peacetime periods (except in the aftermath of war) we've managed to keep prices reasonably stable—our economy has not had an inflationary "bias".

Despite this record, the idea has gained wide acceptance that new forces are at work that will automatically push up prices. The thesis runs this way:

- Wage rates will rise more rapidly than productivity as management and unions compromise each year on new wage demands.

- The efforts of the government to keep production and employment high will lead to a persistent increase in the money supply via the deficit spending route.

This idea evolved under the most unusual circumstances of the early post-war period. It was a shortage era—industry lacked the capacity to meet all demands. It was easy to pass on higher wages by increasing prices. And, because of the wartime growth in the money supply there was plenty of purchasing power around. So prices rose even though the Federal Government ran a cash surplus.

Greater Productivity

Conditions are different now. Industry has the capacity to turn out a vast flood of production. Thus, competition should help hold down prices.

Productivity has been growing at a remarkably rapid pace—almost 4% per year as against the long-term average of 2.1% and almost no gain in the early post-war years.

If we can keep up the pace of rising productivity we should be able to support considerably larger annual wage increases than were typical in the 1930's without pushing up the general average of prices. Even so, very large wage increases, like the recent 7½% increase in steel wages, are bound to affect specific prices. In coming months there may be numerous examples of individual products where higher costs force prices up (particularly in capital goods lines). Yet such price increases are not likely to be so general as to have a large impact on the over-all price indices.

Recent experience lends little support to the view that government must inevitably pursue an inflationary policy to maintain high-level production and employment. Through a combination of fiscal and monetary measures the increase in the money supply was held to only 1.6% in 1953 as against 3.6% in 1952. But it expanded 3.1% in 1954. Thus the net effect of government economic policies was to hold down the supply of purchasing power in early 1953 when inflation threatened, and to ease money and credit in 1954 when the problem was to cope with a mild business recession.

Government Economic Policies

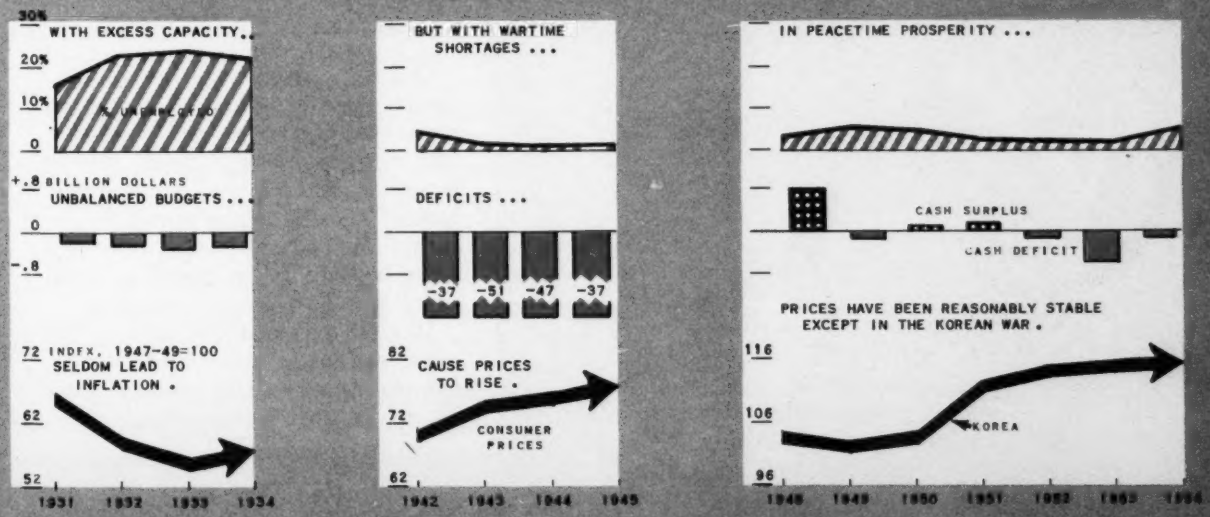
The Committee for Economic Development and certain other organizations have recently suggested that government economic policies in the future should attempt to:

- Restrain inflationary pressures at times when the economy is operating at capacity by running a cash budget surplus and keeping a tight rein on money and credit;

- Cushion business declines in recessions and help promote rapid recovery by easing the credit situation and adopting a budgetary policy designed to encourage business expansion.

It would be the expectation of those who advocate these policies that the government's cash budget would at least be balanced over the business cycle — with surpluses in good times offsetting deficits in times of recession. Such a course, however, would take resolute action on the part of Congress, particularly in periods of prosperity. Moreover, action by government is not enough. Both labor unions and management would continue to bear a heavy responsibility in keeping wage increases within the limits set by rising productivity.

THE FEDERAL BUDGET, UNEMPLOYMENT, AND PRICES



DATA: CENSUS BUREAU, BUDGET BUREAU, B.L.S. AND NAT'L. BUREAU OF ECON. RESEARCH

WORLD ENERGY RESOURCES

Future Trends in Sources and Output

World energy consumption has grown more than seven times since 1800. And all factors point to an even more rapid growth in the future. However, most of our traditional sources of energy cannot be renewed; and some may become seriously depleted in the next 50 years.

Cheap energy is a key ingredient in rising productivity. If the world is to make progress in raising living standards in the period ahead, energy use must grow rapidly. Can adequate new sources be developed?

Vast new sources of supply—notably atomic and solar energy—are available today. At present, their cost is too high for wide economic use. But eventually they may become as cheap as coal and oil.

Thus, the prospects for adequate energy are bright.

Long-Run Energy Trends

In the last 100 years the use of energy has grown with accelerating speed. For thousands of years man consumed no more energy than was required for bare subsistence. With the discovery of fire and the domestication of animals, per capita energy consumption rose to an equivalent of 1100 pounds of coal each year.

Then, with the coming of the machine age, energy consumption sky-rocketed. In the United States today, no less than an equivalent of 18,000 pounds of coal are consumed per person—about 55 times more than required for bare subsistence.

Moreover, new sources of energy have been found and new methods of using them have been developed.

- World coal consumption increased ten-fold from 1820 to 1860 and another 10 times since then.
- Petroleum production, insignificant until the 1880's, has risen to more than 3.5 billion barrels a year.
- Since 1900 natural gas and water power—relative newcomers—have increased their contribution to world energy more than 25 and 40 times respectively.

But while the over-all expansion in energy has been enormous, great differences exist among geographic areas. The U.S. consumes coal, oil and water power at an energy equivalent of more than 18,000 pounds of coal per person each year. Europe consumes about 5,600 pounds.

Moreover, the underdeveloped countries of Asia—where nearly half the people of the world live—consume coal, oil, and water power at an annual rate of little more than 100 pounds of coal per person. In the U.S. this amount is used by one person in two days.

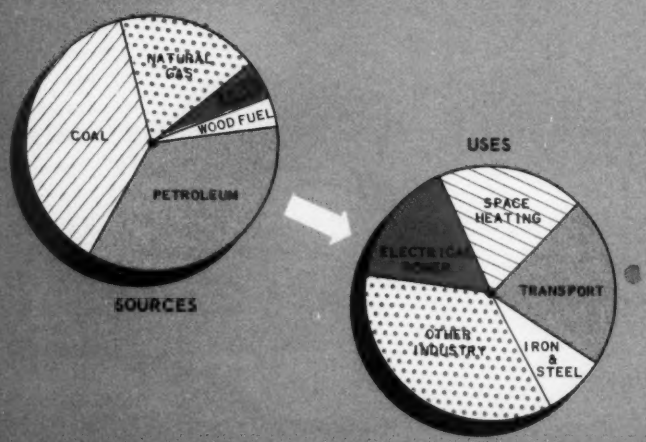
Future Energy Consumption

How much energy will be consumed in the future? And what will our future sources of energy be? No firm estimates can be made, for the answer depends on long-run trends in population, industrialization, and technology that cannot be predicted accurately.

Still, the demand will be enormous. For example:

- In the U.S. alone, the demand for energy rose more than 60% from 1930 to 1950. A continuation of this trend would mean a tripling by the year 2000.

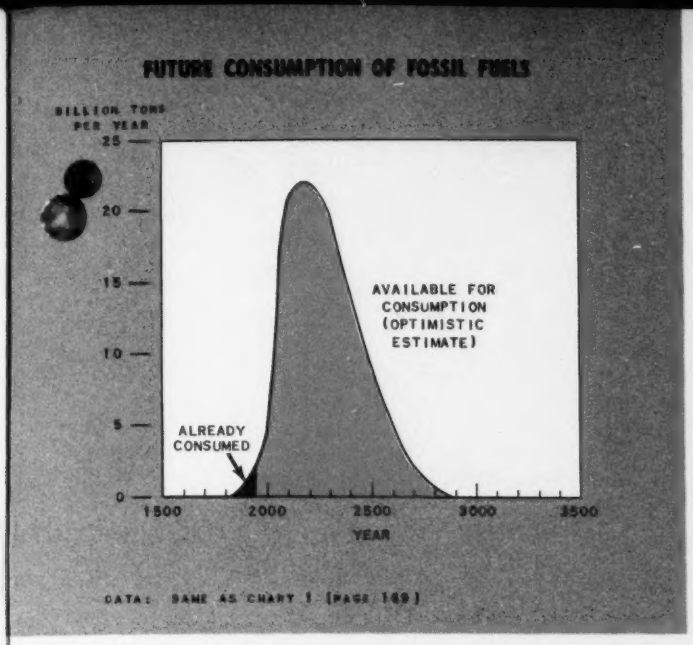
SOURCES AND USES OF ENERGY IN THE UNITED STATES (1948-9)



Coal and petroleum are our two major sources of energy. About 17% of coal output is used in iron and steel production; 25% in space heating. Nearly 50% of petroleum is used for transportation. Natural gas, next in importance, is used mainly for industrial production and space heating. Water power is exclusively devoted to electric generation.

All in all, transportation takes up 22% of our total energy output; space heating, 18%; electric power, 16%; iron and steel, 8%; and all other industry, 35%.

DATA: HARRISON BROWN "THE CHALLENGE OF MAN'S FUTURE" NEW YORK, 1954 (PAGES 151 AND 154).



• Moreover, as the underdeveloped countries industrialize, the rate of increase for the world may be even faster.

At the very least world energy demand should triple by the turn of the century; in all probability it will more than quadruple. However, the composition of our present supplies will change.

Fossil Fuels

Most of our traditional sources of energy (coal, oil, gas) are limited. These sources, known as "fossil fuels", were formed under special geological conditions which may never occur again.

What's more, we are beginning to cut deeply into these sources. By 1950, 80 billion tons of coal had been mined, 75% of it since 1900; over 70 billion barrels of oil had been pumped out, almost all of it since 1900.

Geologists' estimates of remaining supplies of coal, oil and gas vary enormously—from 800 billion tons to 8,000 billion tons (in terms of equivalent tons of bituminous coal). Despite the wide range of these differences, however, it is clearly only a matter of time before supplies of various fossil fuels become badly depleted.

Even so, ample reserves remain for a considerable period ahead. Coal and oil production should continue to rise for some time. By 2000 A.D. fossil fuels will probably still remain our major source of supply.

By that time, however, the world may have passed its peak production in petroleum. But coal use will rise markedly as liquid fuels are made synthetically from coal, shale and other raw materials. More than three billion tons of coal may be consumed in the year 2000 A.D. for energy—almost twice the current annual production.

In the United States alone, fossil fuels might last anywhere from 75 to 250 years, depending on the actual size of reserves and the future rate of economic growth.

Clearly, other sources of energy will soon begin to gain in importance. Wind and water—renewable energy sources—will be more fully developed.

At present, the United States uses most (about 70%) of its available water power. But in other areas of the world, a beginning has scarcely been made.

In Africa, which has the largest sources, only 0.1% is being used. And for the world as a whole, only about 13% of the maximum potential has been developed. In addition, power generated by wind should grow as new techniques are developed.

However, even full development of wind and water power would match only a small percentage of our energy needs. Thus, new sources must be tapped.

Atomic and Solar Energy

Fortunately, man has access to two almost inexhaustible sources—solar radiation from the sun and atomic energy from man-made nuclear reactions.

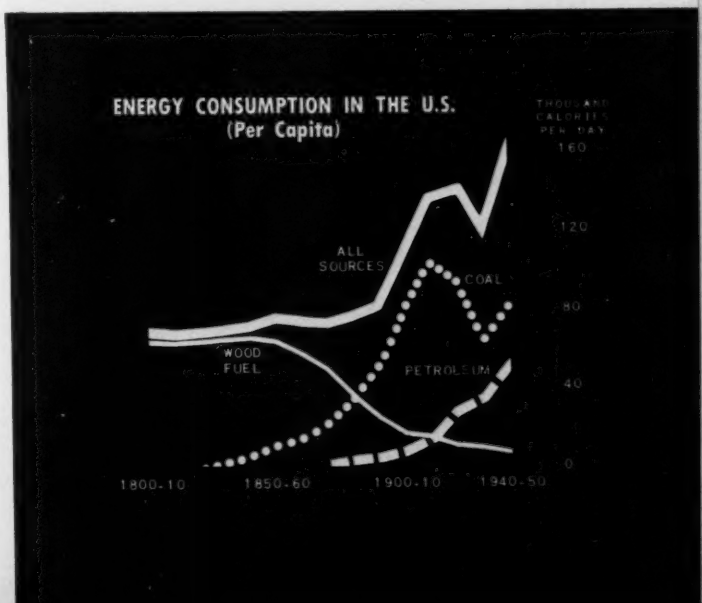
In only three days we receive as much energy from the sun as could be obtained from burning all of our reserves of coal, oil, gas and wood together.

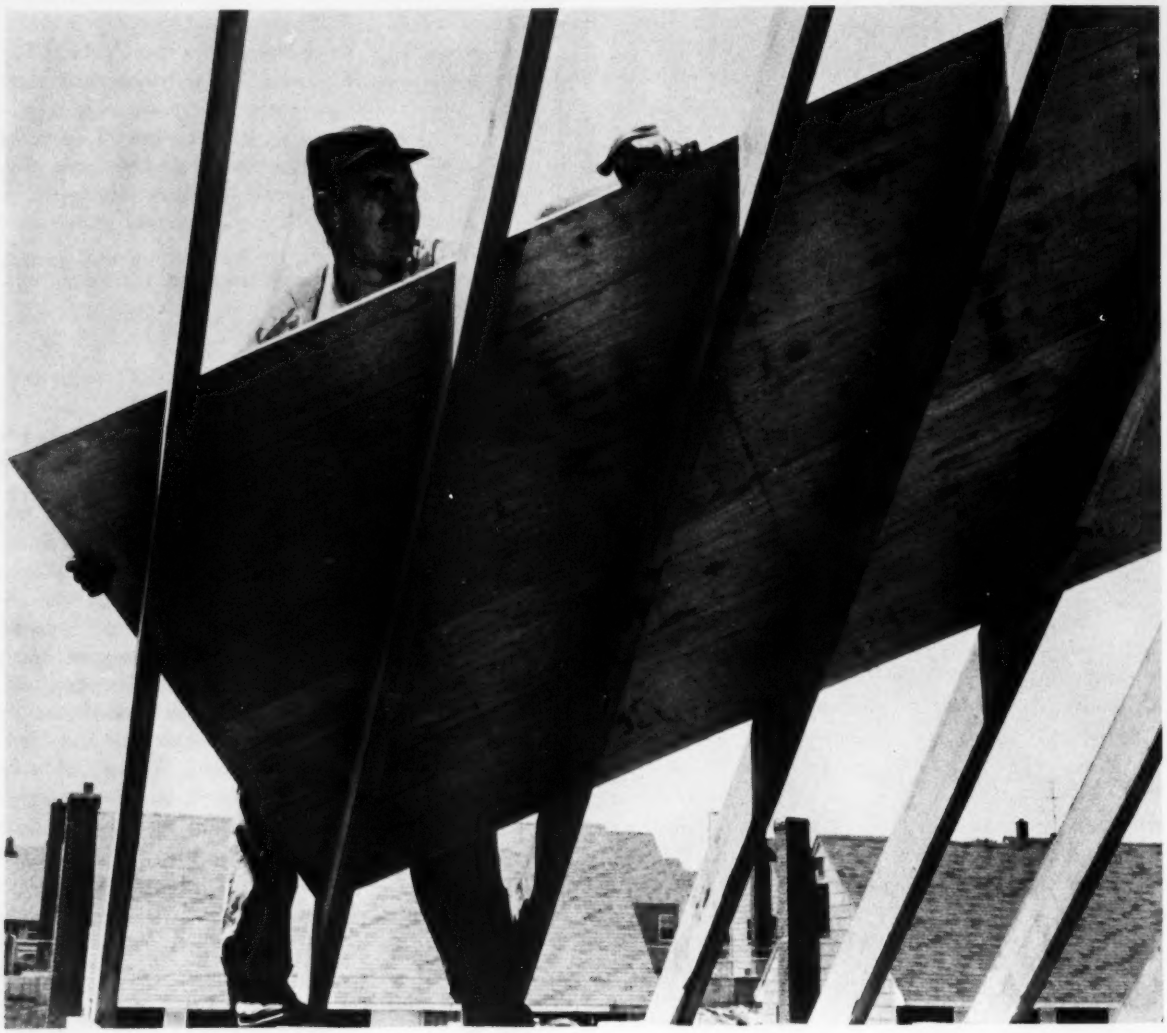
Moreover, the supplies of uranium and thorium contained in rock may provide atomic energy for thousands of years. There will clearly be no shortage of energy sources for many years. As fossil fuels disappear solar energy will be used increasingly for space heat and atomic energy for power.

The big question here is not one of availability but of costs. Can we convert these new sources into power as cheaply as we convert coal and oil into energy today?

Costs may remain high for some time. Thus, coal and oil will probably continue to dominate our energy supply for at least 50 years.

However, research and development on new sources of energy has been rapid. At present rates of development, atomic and solar energy may make up 10 to 20% of our vastly larger energy supply in 2000 A.D. And, what's equally important, by that time they may cost no more, or even less, than energy sources today.





On the beam for plywood

Unknown 50 years ago, the Plywood Industry now helps house America from basement to roof. Here's the story and the part commercial banks played in it.

Half a century ago plywood's light was literally hidden under a basket.

The story begins at the Lewis and Clark World's Fair in Portland, Oregon. The year was 1905. And for the first time fair-goers saw American-made Douglas fir plywood—humbly fashioned into fruit baskets!

Hardly anyone who looked at the new-fangled product foresaw its future. But a handful of imaginative lumbermen did. And to help develop our modern plywood industry they turned to banks.

TIMBER!

Today bank loans provide cash for felling and transporting trees. Bank loans help pay for machinery to peel giant logs down to supple veneers, and to cross-bond them into incredibly strong plywood panels. And on the retail side, bank loans frequently help local merchants stock everything from rugged exterior plywood to artistic interior panels.

PROSPERITY ACROSS THE BOARD

The results you can see everywhere about you... quicker construction, more varied beauty in homes and offices, greater strength and versatility wherever wood is used.

Bank help to the plywood industry affects all of our people, because money put to work by commercial banks results in more jobs for men and women. This in turn means more production, and a higher standard of living for all of us.

The Chase Manhattan Bank, a leader in loans to American industry, is proud of banking's contribution to the plywood industry and to the continuing progress of our country.

THE CHASE MANHATTAN BANK

(MEMBER FEDERAL DEPOSIT INSURANCE CORPORATION)